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No. 94-1868

In the
Supreme Court of the United States
October Term, 1994

NORTH CAROLINA POWER,
Petitioner,

v.

STATE OF NORTH CAROLINA *ex rel.*
UTILITIES COMMISSION,
Respondent.

Petition for a Writ of Certiorari from the Supreme Court of North Carolina

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Does a state violate the Supremacy Clause when, in the exercise of its retail ratemaking authority, it disallows QF capacity costs set in excess of avoided costs by another state, when that other state was acting pursuant to its laws and policies and not in accordance with § 210 of PURPA?

2. Does a state violate the Commerce Clause when, in the exercise of its retail ratemaking authority, it disallows QF capacity costs set in excess of avoided costs by another state, when that other state was acting pursuant to its laws and policies and not in accordance with § 210 of PURPA?

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BRIEF IN OPPOSITION

Respondent Public Staff - North Carolina Utilities Commission respectfully requests that this Court deny the petition for a writ of certiorari seeking review of the decision of the Supreme Court of North Carolina in this case.

ADDITIONAL STATUTORY AND REGULATORY PROVISIONS

The pertinent texts of the statutes and regulations listed below are set out verbatim in the Appendix at 1a-4a.

The following provisions of the Federal Power Act:

16 U.S.C. § 824(a) (1988).

16 U.S.C. § 824a-3(b) (1988).

16 U.S.C. § 824a-3(e)(1) (1988).

16 U.S.C. § 824(b)(1) (1988).

The following provisions of the Regulations Under the Public Utility Regulatory Policies Act of 1978:

18 C.F.R. § 292.101(b)(6) (1995).

18 C.F.R. § 292.304(d)(2) (1995).

18 C.F.R. § 292.601(a)-(c) (1995).

STATEMENT OF THE CASE

A. Introduction

The Statement of the Case set forth in the Petition of Virginia Electric & Power Company, d/b/a North Carolina Power in North Carolina (Petitioner), contains a summary of its argument in addition to its statement of the facts of this case. Respondent Public Staff will address Petitioner's arguments in subsequent sections of this brief. This counterstatement of the case contains a more accurate and complete statement of the facts and the procedural history of this case.

B. Proceedings Below

1. *The Virginia Proceedings*

The arbitration proceedings that gave rise to the purchased power expenses in controversy in this case arose out of Petitioner's decision in 1986 to deal with offers from facilities qualifying under § 210 of PURPA[1] by conducting a competitive solicitation. It made this decision because it was receiving offers in amounts greater than its needs for the foreseeable future. Petitioner initiated its solicitation process in December 1986 by sending letters to potential sellers, including Ultra Cogen Systems, Inc.,[2] at its request. Pet. App. 62a. The solicitation letter specified capacity and energy charges that reflected the projected costs of Petitioner's planned Chesterfield 7 unit. Pet. App. 141a.

Petitioner sought 700 MW of capacity from its 1986 solicitation and received bids of 5,083 MW in response. Pet. App. 58a. Ultra Cogen submitted proposals to sell power from nine projects. Ultra Cogen's proposals were rejected in March 1987 because the proposed price was excessive and Ultra Cogen was unwilling to accept certain terms and conditions. Petitioner offered to purchase energy only from Ultra Cogen. Pet. App. 62a. In June 1987, Petitioner signed contracts for seven other projects and 1,264 MW that were offered in the 1986 solicitation. Pet. App. 58a.

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[1] The Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 (1988 & Supp. V 1993). Section 210 of PURPA requires utilities to purchase power from cogeneration and small power production facilities that meet the technical and ownership criteria developed by the Federal Energy Regulatory Commission (FERC). A facility that meets these criteria is deemed to be a "qualifying facility" or QF.

[2] Ultra Cogen Systems, Inc., was succeeded in interest by Hadson Power and later by LG&E Development. The QF and the contracts at issue in this case were referred to as both Ultra Cogen and Hadson in the proceedings below. They will be referred to as Ultra Cogen in this brief.

In October 1987, the Virginia State Corporation Commission (VSCC) initiated a generic review of competitive bidding and its compliance with § 210 of PURPA. Pet. App. 63a. Between November 12, 1987, and December 3, 1987, while the VSCC's generic review was underway, Ultra Cogen filed petitions with the VSCC asking it to order Petitioner to enter into power purchase agreements that included payments for capacity. Ultra Cogen's first petition for arbitration involved a proposed cogeneration facility at The Lane Company, Inc. (Lane), in Altavista, Virginia. The petition indicated that the facility would burn coal expected to be from or transloaded in Virginia, that there were significant benefits to Lane and its ability to continue to operate and employ 1,200 people, that approximately $60 million would be invested in the Altavista area which was of critical importance to the future economic health of Lane and the City of Altavista, and that jobs and economic benefits to the community and the Commonwealth would result. App. 6a-7a; Pet. App. 63a-64a.

On January 29, 1988, the VSCC issued its policy statement on competitive bidding, concluding that federal law did not require a utility to pay full administratively-determined avoided costs and that avoided costs could be determined through competitive bidding. The VSCC's policy statement went on to provide that, in evaluating specific proposals, favorable weight should be assigned to the use of Virginia fuels, manpower, and other state resources; the benefits to be derived by the industries and communities associated with particular projects; and other identifiable economic and societal benefits to the people of Virginia. Pet. App. 63a.

By order dated February 26, 1988, the VSCC rejected Petitioner's requested dismissal of Ultra Cogen's petitions on the ground that the VSCC had approved the use of competitive bidding. The VSCC decided that it would arbitrate Ultra Cogen's petitions and designated Commissioner Thomas P. Harwood, Jr., to serve as arbitrator. Pet. App. 164a-168a.

On March 1, 1988, Petitioner initiated a second solicitation. Petitioner's position in the arbitration proceedings was that the prices resulting from its competitive bidding solicitations should be used to set prices for the Ultra Cogen contracts. The Virginia arbitrator disagreed. By memorandum issued on April 27, 1988, he required the contracts to be based on the costs of constructing and operating Petitioner's Chesterfield 7, as projected on the date the first petition for arbitration was filed. The memorandum further noted that Petitioner's position in other dockets had been that Chesterfield 7 could and should serve as a basis for its avoided cost calculations because that unit was intended to be the prototype of any new capacity to be built by Petitioner through the mid-1990's. Pet. App. 172a.

On May 27, 1988, the arbitrator issued his interim order establishing capacity and energy prices, along with other key terms and conditions, for four of Ultra Cogen's proposed projects. This order merely recited his previous conclusion that the pricing proposal be based on the costs of Chesterfield 7 and that consideration be given to the expected capacity factors of the plants. The $341/kW capacity price for the Ultra Cogen projects was stated in an appendix, without any explanation as to how it was derived. Ultra Cogen's energy prices were established based on the assumption that coal prices would increase in the future.[3] Pet. App. 179a.

On September 30, 1988, the arbitrator entered his final order requiring Petitioner to sign the contracts. This order expressly recognized that "the Agreements reflect negotiations and rulings based on the unique circumstances of these proceedings (including that they are coal-fired cogeneration facilities in lesser populated areas of the Commonwealth)." Pet. App. 189a.

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[3] Petitioner's fuel reports on file with the North Carolina Utilities Commission (NCUC) showed that from 1984 through 1987 the cost of coal was decreasing and that it had remained relatively stable up to the time of the NCUC's order. Pet. App. 65a.

Petitioner signed the contracts on October 7 and 8, 1988. It did not appeal the VSCC arbitration orders. During December 1988 and January 1989 Petitioner signed contracts for the projects resulting from its 1988 solicitation. Pet. App. 65a.

On February 13, 1990, Commissioner Harwood issued an order granting a certificate of public convenience and necessity to Doswell Limited Partnership (Doswell).[4] In this order, he stated that payments for the Doswell projects, which resulted from the 1986 solicitation, were based on the avoided costs of Chesterfield 7 and were reasonable. App. 19a-20a; Pet. App. 73a.

2. *The North Carolina Utilities Commission Proceeding*

On July 31, 1992, Petitioner filed an application with the NCUC for an increase in its North Carolina retail rates. During this proceeding, the NCUC's Public Staff advocated the disallowance of $1.39 million of the Ultra Cogen capacity payments, the amount allocated to North Carolina by which they exceeded Petitioner's avoided costs at the time Ultra Cogen filed its arbitration petitions.[5] Pet. App. 66a. With respect to Petitioner's pre-emption argument, the NCUC's order noted that PURPA provides that avoided cost rates may not exceed the

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[4] *Doswell Limited Partnership*, 110 P.U.R.4th 273 (Va.St.Corp.Comm'n (1990). Doswell's predecessor in interest, Intercontinental Energy Corporation, was a QF. It had been selected in the 1986 solicitation and signed contracts for two plants. These contracts were assigned to Doswell. Doswell, as a nonQF, independent power producer subject to the Federal Power Act (FPA), 16 U.S.C. §§ 791-825u (1988 & Supp. V 1993), filed the contracts for approval by the FERC. They were approved in *Doswell Limited Partnership*, 50 FERC ¶ 61,251, 110 P.U.R.4th 261 (1990).

[5] The NCUC's order found (Pet. App. 36a) and Petitioner stipulated to the North Carolina Supreme Court that the Ultra Cogen contracts had not been filed with the NCUC at the time it issued its order on February 26, 1993.

incremental cost of alternatives and that they must be reasonable to consumers. The NCUC's order further noted that generating facilities that qualify under § 210 of PURPA (QFs) are exempt from the FPA and that Congress did not intend to divest state regulatory commissions of their ratemaking authority with respect to QF contracts. Pet. App. 66a-68a.

The NCUC compared the Ultra Cogen contracts with other, contemporaneous measures of avoided costs and concluded that the prices in the Ultra Cogen contracts exceeded Petitioner's avoided costs at the time the arbitration petitions were filed.[6] Pet. App. 72a-73a. The NCUC examined the facts surrounding Petitioner's 1986 solicitation and its results; the costs and capacity factors of the Doswell plants, which resulted from the 1986 solicitations; and the costs and capacity factors resulting from Petitioner's 1988 solicitation. The uncontroverted evidence showed that the 1986 solicitation used Petitioner's proposed Chesterfield 7 plant as its benchmark, and the evidence established that the bids came in "right at the benchmark price." Pet. App. 73a. The NCUC therefore concluded that the average annual capacity payments of $141/kW resulting from the 1986 solicitation more accurately reflected the costs of the Chesterfield 7 plant, as projected in 1987,[7] than the arbitrator's unsupported $341/kW capacity payments.[8] In addition, the NCUC noted that the

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[6] The NCUC's order also noted that the Ultra Cogen payments were out of line with Petitioner's approved avoided costs rates in North Carolina at the time the Ultra Cogen contracts were executed. If those rates had been used, the Ultra Cogen capacity would have cost Petitioner $17 million instead of the $64 produced by the arbitrator's order. Pet. App. 73a.

[7] The contracts for the projects resulting from the 1986 solicitation, including the Doswell contracts, were signed in June 1987. App. 13a, Pet. App. 58a.

[8] The NCUC's order also discussed the capacity factors of the various projects it reviewed. Because Petitioner uses the plants with the cheapest energy costs first, similarity in capacity factors would eliminate any justification for higher capacity payments. The Ultra Cogen projects had an average capacity

Virginia arbitrator himself stated in a February 1990 order that payments for the Doswell projects, which resulted from the 1986 solicitation, were based on the avoided costs of Chesterfield 7 and were reasonable. The Doswell capacity payments were $146/kW, compared to the $341/kW for the Ultra Cogen projects. Pet. App. 73a. The NCUC then used the results of Petitioner's 1988 solicitation to *increase* the amount included in North Carolina retail rates because the contracts resulting from it were signed at approximately the same time as Ultra Cogen's. Pet. App. 76a.

The NCUC's order also stated that it was very clear from the record that the VSCC's treatment of the Ultra Cogen projects was directly related to expected benefits to Virginia from these projects, reciting the "unique circumstances" language from the arbitrator's final order and the economic development benefits to Virginia cited in Ultra Cogen's arbitration petition. The NCUC noted that these benefits flow to Virginia, not to North Carolina. The NCUC stated that it could not "find these expenses to be reasonable for our purposes when they are well over twice contemporaneous measures of avoided capacity costs and they were clearly influenced by economic benefits unique to the State of Virginia." Pet. App. 74-75a. For this reason, the NCUC concluded that while it may be reasonable for Virginians to pay the extra costs associated with the Ultra Cogen projects, it was not reasonable for North Carolinians to pay such extra costs. Pet. App. 74a.

3. *The North Carolina Supreme Court's Decision*

On appeal to the North Carolina Supreme Court, Petitioner argued that the NCUC's disallowance of $1.39 million in expenses for the capacity payments for the Ultra Cogen projects violated

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factor of 27%, while the projects resulting from the 1986 and 1988 solicitations had combined capacity factors of 32% and 36%, respectively. Pet. App. 8a and 75a-76a.

PURPA and the Commerce Clause of the United States Constitution. In response to Petitioner's reliance on *Nantahala Power & Light Company v. Thornburg*[9] and *Mississippi Power & Light Company v. Mississippi ex rel. Moore*[10] to support its pre-emption arguments, the North Carolina Supreme Court noted that those cases address the pre-emptive effect of a rate or apportionment *set by the FERC* for a wholesale transaction subject to regulation under the FPA. The Court further pointed out that, under the FERC's regulations, the purchase price for power sold by QFs is exempt from regulation by the FERC, and the rates *are determined by the states* under the federal rules.

The North Carolina Supreme Court noted that under the express terms of § 210 of PURPA and the FERC's regulations, the purchase price for QF power cannot exceed avoided costs. Its opinion noted that the FERC's earlier position that the states were free, under their own authority, to approve rates higher than avoided costs had been reversed by the FERC in *Orange and Rockland Utilities*.[11] Pet. App. 5a.

The North Carolina Supreme Court concluded that the VSCC had to apply the avoided cost rule in determining the rates for the Ultra Cogen projects and held that, if the NCUC disallowed only that portion of the Ultra Cogen capacity payments that was *above* avoided costs, its disallowance did not violate PURPA (and therefore was not pre-empted). Pet. App. 6a. The court then examined the evidence to determine whether competent evidence supported the NCUC's finding that the price for capacity set by the Virginia arbitrator was unreasonably high compared to

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[9] 476 U.S. 953 (1986).

[10] 487 U.S. 354 (1988).

[11] 43 FERC ¶ 61,067, 92 P.U.R.4th 1 (1988)(holding that it is impermissible for the states to impose rates exceeding avoided costs).

contemporaneous measures of Petitioner's avoided costs. The court's opinion recited the following evidence:

(1) The 1986 solicitation, which was based on the costs of Chesterfield 7, produced average capacity costs of $141/kW, compared to $341/kW for the Ultra Cogen projects. The 1986 projects were expected to operate at a 32.2 percent capacity factor compared to 27.1 percent for the Ultra Cogen projects, thus eliminating any justification for the higher capacity costs on the basis of lower energy costs. Pet. App. 7a-8a;

(2) The Virginia arbitrator himself stated in a February 1990 order that payments for the Doswell projects, which were offered by Doswell's predecessor in interest in the 1986 solicitation, were based on the avoided costs of Chesterfield 7 and were reasonable. The capacity costs for the Doswell projects were $146/kW, while the capacity costs for the Ultra Cogen projects were $341/kW. Furthermore, the Ultra Cogen projects' average capacity factor, based on economic dispatch, was approximately one-half that of the Doswell projects, which indicates the Ultra Cogen projects' energy costs are greater. Pet. App. 8a; and

(3) The seven projects that were selected in the 1988 solicitation and were operational at the time of the hearing have an average capacity cost of $171/kW and a combined capacity factor of 35.9 percent. The results of the 1988 solicitation were then used as a proxy for what the costs of Chesterfield 7 (and the 1986 solicitation projects) would have been at the time the Ultra Cogen contracts were signed. Using the results of the later solicitation did not prejudice Petitioner but rather allowed it to include $30/kW (or $240,000) more in rates. Pet. App. 8a.

Based on its review of the foregoing evidence, the North Carolina Supreme Court concluded that the NCUC's findings were supported by competent evidence. It therefore held that, because the NCUC's exclusion of the $1.39 million in expenses for

capacity payments to Ultra Cogen was nothing more than the disallowance of the amount by which the contract price exceeded Petitioner's avoided costs, there was no violation of PURPA. Pet. App. 10a.

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

I. THE NORTH CAROLINA SUPREME COURT'S OPINION IS CONSISTENT WITH THIS COURT'S SUPREMACY CLAUSE DECISIONS.

A. Introduction

Petitioner argues that the North Carolina Supreme Court's decision conflicts with this Court's Supremacy Clause decisions and violates PURPA. Respondent will show that, because the NCUC order affirmed by the North Carolina Supreme Court disallowed only the portion of the Ultra Cogen capacity costs that exceeded Petitioner's avoided costs at the time the arbitration petitions were filed, it is consistent with § 210 of PURPA and the FERC's regulations. The North Carolina Supreme Court's decision therefore recognizes the supremacy of federal law and is in strict accordance with this Court's decisions.

B. This Court's Supremacy Clause Decisions and the Requirements of § 210 of PURPA

It is well-established that Congress has the power under the Supremacy Clause of Article VI of the Constitution to pre-empt state law. Determining whether Congress has exercised this

power requires an examination of congressional intent.[12] In the absence of explicit statutory language, this Court infers such intent in three specific situations: (1) where Congress has legislated comprehensively to occupy an entire field of regulation, leaving no room for the states to supplement federal law, *Rice v. Santa Fe Elevator Corporation*;[13] and (2) where the state law at issue conflicts with federal law, either because (a) it is impossible to comply with both, *Florida Lime & Avocado Growers, Inc. v. Paul*,[14] or (b) the state law stands as an obstacle to the accomplishment and execution of congressional objectives. *Hines v. Davidowitz*.[15]

Early in this century, this Court fashioned a bright line dividing permissible from impermissible state regulation. This Court, in *Missouri ex rel. Barrett v. Kansas Natural Gas Company*, held that the retail sale of natural gas was subject to state regulation, "even though the gas be brought from another State and drawn for distribution directly from interstate mains."[16] This Court further held that the wholesale sale of gas in interstate commerce was not subject to state regulation.[17] This wholesale/retail line was applied to the electric industry in *Public Utilities Commission v. Attleboro Steam & Electric Company*.[18]

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[12] *E.g., Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983).

[13] 331 U.S. 218, 230 (1947).

[14] 373 U.S. 132, 142-143 (1963).

[15] 312 U.S. 52, 67 (1941).

[16] 265 U.S. 298, 309 (1924).

[17] *Id.* at 307

[18] 273 U.S. 83 (1927).

As a direct result of *Attleboro* and its predecessor cases, Congress established federal regulation over most of the wholesale transactions of electric and gas utilities by enacting the Federal Power Act (FPA)[19] and creating the Federal Power Commission (now the FERC) to carry out that regulation. The FPA defines the sale of electric energy at wholesale as "a sale of electric energy to any person for resale."[20]

This Court has consistently recognized that the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the states.[21] With respect to areas claimed to have been pre-empted that have been traditionally occupied by the states, such as the regulation of utilities, this Court stated that "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."[22]

The explicit language and the legislative history of the FPA indicate that Congress did not intend to supersede the regulatory powers of the states. To make this point clear, § 210(a) of the FPA[23] provides that federal regulation is to extend only to those matters that are not subject to regulation by the states. In addition, § 201(b)(1)[24] provides that, other than for a

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[19] 16 U.S.C. §§ 791-825u (1988 & Supp V 1993).

[20] *Id.* § 824(d) (1988).

[21] *See Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190 (1983)(*Pacific Gas*); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947)(*Rice*); *Munn v. Illinois*, 94 U.S. 113 (1877).

[22] *Pacific Gas*, 461 U.S. at 206 (1983), *quoting Rice*, 331 U.S. at 230.

[23] 16 U.S.C. § 824(a) (1988).

[24] *Id.* § 824(b)(1) (1988).

few exceptions not relevant here, Part II of the FPA does not apply to any sale of electric energy other than a sale at wholesale. This Court recently described this section as "the 'savings clause' of the [FPA], which reserves to the States the regulation of local retail rates."[25]

The legislative history of the FPA also supports the conclusion that retail ratemaking was reserved to the states. Congress intended that its legislation "tak[e] no authority from State commissions."[26] In addition, the limiting clause in § 201(a) of the FPA was viewed as protecting the states' regulation of local affairs, including rates for intrastate and interstate-for-consumption sales.[27]

The language and legislative history of § 210 of PURPA show no intention to change this reservation of authority in the states to regulate local retail rates. As discussed by this Court in *Federal Energy Regulatory Commission v. Mississippi*,[28] Congress enacted § 210, as part of a comprehensive package of energy legislation, to encourage certain nontraditional generating facilities to reduce this country's demand for traditional fossil fuels. Congress believed two problems impeded the development of these nontraditional facilities: (1) traditional electric utilities were reluctant to purchase power from and sell power to them and (2) regulation by federal and state utility authorities imposed financial burdens on them and thus discouraged their development.

To overcome the first of these perceived problems, § 210(a) of PURPA directed the FERC, in consultation with state

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[25] *Wyoming v. Oklahoma*, 502 U.S. 437, 457 (1992).

[26] H.R.Rep.No. 1318, 74th Cong., 1st Sess., 8 (1935).

[27] H.R.Rep.No. 5423, 74th Cong., 1st Sess., 385 (1935).

[28] 456 U.S. 742, 750-51 (1982).

regulatory authorities, to promulgate "such rules as it determines necessary to encourage cogeneration and small power production."[29] To solve the second perceived problem, § 210(e) directed the FERC to prescribe rules exempting QFs from all or part of the FPA, from the Public Utility Holding Company Act of 1935 (PUHCA),[30] and from state public utility laws, if the FERC found such exemption to be necessary to encourage QFs.[31]

In § 210(b), Congress provided that the rate to be set by the FERC must (1) be just and reasonable to the electric consumers of the electric utility and in the public interest and (2) not discriminate against qualifying cogenerators or qualifying small power producers. It further provided that no rule prescribed under § 210(a) "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy."[32]

The FERC subsequently adopted regulations to implement § 210 of PURPA.[33] These regulations define "avoided costs" as the costs to an electric utility of energy or capacity or both which, but for the purchase from the QF, the electric utility would generate or construct itself or purchase from another source.[34] Electric utilities are required to purchase electricity from QFs at a rate equal to their full avoided costs.[35]

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[29] 16 U.S.C. § 824a-3(a) (1988).

[30] 15 U.S.C. §§ 79 to 79z-6 (1988 & Supp V 1993).

[31] 16 U.S.C. § 824a-3(e) (1988 & Supp V 1993).

[32] *Id.* § 824a-3(b) (1988).

[33] 18 C.F.R. §§ 292.101-.602 (1995).

[34] *Id.* § 292.101(b)(6) (1995).

[35] *Id.* § 292.304 (1995).

The regulations further provide that QFs are exempt from all sections of the FPA (with the exception of several sections that are not relevant here), from PUHCA, and from state law or regulation with respect to the rates and the financial and organizational regulation of electric utilities.[36] In the preamble to its regulations, the FERC acknowledged explicitly that its rules were not intended to divest a state regulatory agency of its authority under state laws to review contracts for purchases as part of its regulation of electric utilities, as long as such authority is exercised consistently with § 201 of PURPA and the FERC's regulations.[37]

C. The Consistency of the North Carolina Supreme Court's Opinion With Federal Law

Petitioner concedes that the NCUC actions of which it complains were traditional retail ratemaking actions under state law.[38] Petition at 21. Petitioner also concedes that Congress, in enacting § 210 of PURPA, carved out an exception to the FERC's exclusive jurisdiction over wholesale interstate power transactions by exempting QFs from the FPA. Petition at 20. Petitioner thus has conceded that *Nantahala Power & Light Company v. Thornburg*[39] is not directly applicable. Rather it argues that, because the Virginia arbitrator was purporting to act pursuant to federal law, the NCUC is bound to adhere to his decision "just as though FERC itself had acted." Petition at 25. In addition,

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[36] *Id.* § 292.601-.602 (1995).

[37] *Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, Order No. 69, 45 Fed. Reg. 12,214, at 12,233 (1980)(*PURPA Regulations*).

[38] Petitioner further concedes that the NCUC did not attempt to change the contract between Ultra Cogen and Petitioner. Petition at 18 n.19.

[39] 476 U.S. 953 (1986).

Petitioner argues that the NCUC's retail ratemaking has "trapped" federally determined wholesale costs, just as in *Nantahala*.

Nantahala and *Mississippi Power & Light Company v. Mississippi ex rel. Moore*[40] address the pre-emptive effect of a rate or apportionment *set by the FERC* for a wholesale transaction subject to its regulation under the FPA. Because QFs are exempt from the FERC's ratemaking authority under the FPA and the authority to set avoided cost rates was delegated to the states, not only has the FERC not made a specific rate finding in this case, it has issued no opinion on it whatsoever.[41] Because there are no federally mandated payments or approved allocations of power, the NCUC, by disallowing state-determined avoided costs, did not attempt to revise a previous FERC decision, which makes the holding of *Nantahala* inapplicable.

Thus, Petitioner's entire argument rests on its unsupported contention that the Virginia arbitrator was acting in accordance with § 210 of PURPA and the FERC's regulations when he approved the Ultra Cogen contract prices. To the extent those prices exceed Petitioner's avoided costs, he could not have been acting pursuant to § 210 of PURPA because it explicitly "sets full avoided costs as the maximum rate that the [FERC] may

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[40] 487 U.S. 354 (1988).

[41] Petitioner asserts that the FERC, in *Doswell Limited Partnership*, 50 FERC ¶ 61,251, 110 P.U.R.4th 261 (1990), impliedly affirmed the VSCC's Ultra Cogen decision. Petition at 23 n.32. Actually the FERC's decision merely noted that Doswell's assertion that Chesterfield 7 was an accurate representation of Petitioner's avoided costs was corroborated by the VSCC's adoption of the Chesterfield 7 costs as the standard by which to set avoided cost pricing for four QF projects during the same time period. The FERC did not imply, much less find, that the Ultra Cogen contract rates were actually based on Chesterfield 7. Pet. App. 150a.

prescribe."[42] In the preamble to its regulations, the FERC expressed its opinion that, while its rules were subject to the avoided cost cap, the states were free, under their own authority, to enact laws or regulations for rates higher than avoided costs. The FERC explicitly stated, however, that if a state program required utilities to purchase power from QFs at higher rates, the higher rates would be based on state authority, not on the FERC's rules.[43] Therefore, because the arbitrator approved avoided costs that exceeded Petitioner's avoided costs at the time the arbitration petitions were filed, he was acting pursuant to state law, not federal law, and the NCUC was not bound by his determination.[44]

The only support Petitioner offers for its position is that (1) the Virginia arbitrator stated he was establishing the contract prices as Petitioner's avoided costs and the NCUC cannot recast the Virginia arbitrator's decision from a federal mandate into a state action against the issuing state's wishes and (2) the NCUC and the North Carolina Court were "tellingly silent" on the FERC's regulation that establishes the date on which avoided costs must be determined. Petition at 26-27.

In support of its first contention Petitioner notes that the arbitrator's orders unequivocally state that he was establishing the

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[42] *American Paper Inst. v. American Elec. Power Serv. Corp.*, 461 U.S. 402, 413 (1983).

[43] *PURPA Regulations*, 45 Fed. Reg. 12,214, at 12,221 (1980); *see Middle S. Serv.*, 33 FERC ¶ 61,408, at 61,788-89, 71 P.U.R.4th 580, 590 (1985). The FERC has subsequently reversed this position, holding that a state cannot impose a rate exceeding avoided costs on sales by QFs. *Orange & Rockland Util.*, 43 FERC ¶ 61,067, at 61,195, 92 P.U.R.4th 1, 15 (1988); *accord Connecticut Light & Power Co.*, 70 FERC ¶ 61,012, at 61,029 (1995).

[44] The issues of whether the FERC can pre-empt independent state authority and whether federal authority can be delegated to one state to make determinations that are binding on another state are not raised here because North Carolina strictly complied with § 210 of PURPA and the FERC's regulations.

contract prices as Petitioner's avoided costs in accordance with the FERC's regulations. Petitioner then argues that the arbitrator interpreted the FERC's regulations to require Ultra Cogen's prices to be based on administratively determined avoided costs and not on competitive bidding results. This argument has no merit for two reasons. First, the FERC in *Orange and Rockland* emphasized that whether a rate exceeds avoided costs is a factual question that is independent of whether the rate was *intended* to exceed avoided costs.[45] Secondly, in this particular case, avoided costs determined administratively and avoided costs determined through competitive bidding are the same. The evidence conclusively establishes that the administratively-determined avoided costs judged appropriate for use by the Virginia arbitrator (the costs of Chesterfield 7) and the average results of the 1986 competitive solicitation were the same.[46]

Even if the 1986 solicitation results were ignored, the arbitrator's own Doswell decision demonstrates that the Doswell projects were offered to Petitioner at about the same time as the Ultra Cogen projects and that the contract prices for the Doswell projects were based on the costs of Petitioner's Chesterfield 7 plant. In addition, these plants began selling power to Petitioner within a few months of one another (Doswell on May 3 and May 10, 1992, and Ultra Cogen on February 22, March 7, and July 1, 1992), and the Ultra Cogen projects' average capacity factor, based on economic dispatch, was approximately one-half that of

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[45] *Orange & Rockland Util.*, 43 FERC ¶ 61,067, at 61,196, 92 P.U.R.4th 1, 16 (1988).

[46] As was discussed on pp. 7-8 of this brief, the NCUC found: (1) the 1986 solicitation used Petitioner's proposed Chesterfield 7 plant as a benchmark, (2) the bids came in at the benchmark price, and (3) the contracts were signed in June 1987. As a result, the NCUC concluded that the average annual capacity payments of $141/kW resulting from the 1986 solicitation more accurately reflected the costs of the Chesterfield 7 plant, as projected in 1987, than the arbitrator's unsupported $341/kW.

the Doswell projects, which indicated the Ultra Cogen projects' energy costs were greater. Pet. App. 8a. Thus, the arbitrator's own order establishes that the Ultra Cogen contracts with their $341/kW capacity costs and 27% average capacity factor exceeded the 1987 projected costs of Chesterfield 7. If Chesterfield 7 had actually been used as the basis for the rates set in the Ultra Cogen contracts, the Ultra Cogen projects' and the Doswell projects' capacity costs and factors would have been comparable.

Petitioner's arguments about the use of the results of the 1988 solicitation are equally unavailing. The NCUC simply used the 1988 results ($171 per kW) as a proxy for what the costs of Chesterfield 7 and the results of the 1986 solicitation would have been at the time the Ultra Cogen contracts were signed in late 1988. Using the results of the later solicitation did not prejudice Petitioner but rather allowed it to include higher capacity costs in rates.

The evidence therefore establishes conclusively that the NCUC used the same standard that the Virginia arbitrator found to be appropriate for the determination of Ultra Cogen's avoided cost rates and that the costs of Chesterfield 7, and, therefore, Petitioner's avoided costs, were no more than $171/kW, the amount allowed by the NCUC as reasonable expenses when it established Petitioner's retail rates. The NCUC in fact would have been justified in disallowing an even greater amount (i.e., the amount by which the Ultra Cogen contracts exceeded Doswell's $146/kW capacity costs or the $141/kW average capacity costs resulting from the 1986 solicitation).

Petitioner's second contention, that the NCUC and the North Carolina Supreme Court were "tellingly silent" on the interpretation of the FERC's regulation that establishes the date on which avoided costs must be determined, also is without merit. The relevant FERC regulation, 18 C.F.R § 292.304(d)(2), provides that each QF shall have the option of providing energy or capacity pursuant to a legally enforceable obligation over a

specified term, in which case the rates shall, at the option of the QF be based on either (i) the avoided costs calculated at the time of delivery or (ii) the avoided costs calculated at the time the obligation is incurred.

The preamble to the FERC's regulations indicates that § 292.304(b)(5) and subsection (d) were intended to reconcile the requirement that the rates for purchases equal the utilities' avoided costs with the need of QFs to be able to enter into contractual commitments based, by necessity, on estimates of future avoided costs. The preamble further states that the use of the term "legally enforceable obligation" was used to prevent a utility from circumventing its purchase requirement by refusing to enter into a contract with a QF.[47] Thus, the FERC's purpose in promulgating this regulation was not to dictate the exact date at which avoided costs were to be measured, but rather to make it clear that a QF was entitled to a long-term contract with fixed rates based on the estimate of avoided costs at the time the contract was signed or the QF's obligation to provide power became legally enforceable. The arbitrator himself stated that the date the first arbitration petition was filed constituted the *latest* possible date on which Ultra Cogen became obligated to provide power to Petitioner. Pet. App. 172a.

In any event, as the uncontroverted evidence shows, the results of the 1986 competitive solicitation were equal to the costs of Chesterfield 7, as they were estimated in 1987. The evidence overwhelmingly supports the conclusion that Petitioner's avoided capacity costs in November 1987 were no greater than $171/kW. Moreover, the NCUC's disallowance, which leaves the amount in excess of avoided costs to be recovered in the state that imposed the excessive costs,[48] is consistent with the FERC's proposed

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[47] *PURPA Regulations*, 45 Fed. Reg. 12,214, at 12,224 (1980).

[48] Virginia arguably is pre-empted from disallowing the purchased power expense resulting from the Ultra Cogen contracts because it set the contract rates. *See Pennsylvania Elec. Co.*, 89 P.U.R.4th 402 (Pa.Pub.Util.Comm'n 1988).

solution for multi-state, multi-utility integrated systems subject to its jurisdiction. The FERC declared, in its *Orange & Rockland* decision, that the states would no longer have the authority to approve rates for purchases from QFs in excess of the purchasing utility's avoided costs.[49] The FERC stated that, where a state had already imposed a rate exceeding avoided costs on purchases by a member of a multi-state, multi-utility integrated system, it would require the system to allocate the excessive costs to the utility in the state that imposed the excessive rate if necessary to prevent unfairness to customers in other states. The FERC further stated that localizing excessive costs is important to prevent subsidies.[50]

When the Petitioner's contentions are viewed in light of the uncontroverted evidence and the foregoing decisions, the conclusion is inescapable that the NCUC's actions not only did not violate PURPA or interfere with its goals or enforcement in any way, but rather were entirely consistent with PURPA and actually further its goals. In addition, contrary to Petitioner's claims, no costs have been "trapped." The amount in excess of avoided costs, and therefore not in accordance with federal law, is lawfully recoverable by Petitioner through its retail rates in Virginia, the state that imposed the rates in excess of avoided costs.

D. Conclusion

Each of Petitioner's arguments in support of its contention that the North Carolina Supreme Court's opinion is in conflict with this Court's Supremacy Clause decisions and in violation of PURPA has been demonstrated to be without merit. Contrary to Petitioner's arguments, *Nantahala* and *Mississippi Power* are not

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[49] *Orange & Rockland Util.*, 43 FERC ¶ 61,067, at 61,195, 92 P.U.R.4th 1, 15 (1988). In support of its decision, the FERC stated that rates in excess of avoided cost had an adverse impact on utilities and consumers and that the QF industry had come of age and thus required no additional encouragement. *Id.*

[50] *Id.* at 61,196, 92 P.U.R.4th at 16.

applicable to this case because the FERC did not approve the rates at issue and would have disapproved them if it had had the opportunity.[51] There is no direct conflict between PURPA and state law in this instance because the North Carolina Supreme Court and the NCUC recognized the supremacy of federal law in determining Petitioner's retail rates by disallowing the capacity payments only to the extent they exceed avoided costs.

The evidence also shows that the Ultra Cogen capacity prices established by the Virginia arbitrator were premised on economic benefits unique to the State of Virginia. The NCUC's adjustment to Petitioner's expenses was nothing more than the disallowance of the amount in excess of avoided costs, which, under relevant case law, is recoverable through Petitioner's retail rates charged in Virginia.

There can be no conflict or inconsistency between a federal statute that prohibits payments to QFs in excess of avoided costs and a state retail ratemaking order that disallows recovery of only the excessive payments. Therefore, the decisions of the NCUC and the North Carolina Supreme Court are entirely consistent with this Court's Supremacy Clause decisions.

II. THE NORTH CAROLINA SUPREME COURT'S OPINION IS CONSISTENT WITH THE PURPOSES AND GOALS OF § 210 OF PURPA, AND ANY FEDERAL ISSUES INVOLVED IN THIS CASE ARE NOT OF CURRENT OR GENERAL INTEREST.

Petitioner alludes to three ways in which it believes the North Carolina Supreme Court's decision in this case undermines § 210 of PURPA, thereby raising important federal issues. None of these has any merit.

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[51] *See id.*

Petitioner's first contention is that appropriate and fair implementation of PURPA is essential because so much of this country's electricity production capacity is now being supplied through alternative suppliers. Petition at 17. This development, however, does not mean that these alternative suppliers are QFs seeking to take advantage of § 210 of PURPA. Future generation from QFs actually is expected to decline in importance because of the recent passage by Congress of the Energy Policy Act of 1992 (EPACT).[52] In fact, § 210 of PURPA is now the subject of repeal efforts before Congress.[53]

The EPACT is a comprehensive package of legislation that includes amendments to PURPA, the FPA, and PUHCA for the purpose of encouraging more competition in the generation segment of the electric power industry. For example, before the EPACT's amendments, PUHCA prevented a vertically-integrated utility from selling power from facilities disintegrated from the rest of its power system, and it discouraged the entry of independent power producers (i.e., wholesale, nonrate-based generating facilities) except for the exempted QFs. Because the new PUHCA removes a major constraint on the development of nonQFs, competitive power procurement mechanisms are expected to become the standard industry practice, which in turn will lead to a decline in the importance of future generation from QFs.[54]

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[52] Pub. L. No. 102-486, 106 Stat. 2776 (codified as amended in scattered sections, chiefly 15, 16, and 42 of U.S.C.).

[53] *See* S. 708, 104th Cong., 1st Sess. (1995)(bill to repeal PURPA § 210, 16 U.S.C. § 824a-3).

[54] National Regulatory Research Institute, *A Synopsis of The Energy Policy Act of 1992: New Tasks for State Public Utility Commissions* 38 (1993); *cf. Connecticut Light & Power Co.*, 70 FERC ¶ 61,012, at 61,029 (1995)(states setting rates above avoided costs runs counter to Congress' and the FERC's policies of strongly favoring competition among all bulk power suppliers).

Petitioner's second contention is that disputes over the prices paid to suppliers must be fairly resolved to ensure that PURPA's goals are fulfilled, citing several cases that involve the issue of whether a utility or a state regulatory commission may change the price in a previously approved QF contract. Petition at 17. This case, however, does not involve any attempt to change the price paid to the QF. In fact, Petitioner concedes that the NCUC's action did not change the price the QF receives. Petition at 18 n.19. The only issue this case presents is whether a state regulatory commission can disallow in retail rates the amount by which the rate in a QF contract exceeds avoided costs, the excess of which was approved pursuant to state law rather than federal law. Thus, the cases cited by the Petitioner in its footnote 19 are irrelevant to this case.

The Petitioner's third contention is that regulatory decisions made under PURPA must be immune from collateral attack in order not to undermine federal law. Petition at 19. This issue also is not raised by this case. Federal law has not been undermined by North Carolina's recognition of the limitations imposed by § 210 of PURPA and the FERC's regulations. Indeed, North Carolina fully acknowledged the supremacy of federal law by disallowing for retail ratemaking purposes *only* the amount by which the Ultra Cogen contract prices exceeded Petitioner's avoided costs.

In summary, the North Carolina Supreme Court's decision does not undermine § 210 of PURPA, but rather is fully consistent with it and the FERC's regulations. In addition, because of the current Congressional policy of strongly favoring competition among all wholesale power suppliers, as reflected in the passage of the EPACT, future generation from QFs is expected to decline in importance. Therefore, any federal issues that may be involved in this case are not of current or general interest.

III. THE NORTH CAROLINA SUPREME COURT'S OPINION IS CONSISTENT WITH THIS COURT'S COMMERCE CLAUSE DECISIONS.

It has long been established that, even in the absence of pre-empting Congressional legislation, the Commerce Clause contains an implied limitation on the power of the states to interfere with or impose burdens on interstate commerce.[55] This Court has further stated that the general trend in its "modern Commerce Clause jurisprudence [is] to look in every case to 'the nature of the state regulation involved, the objective of the state, and the effect of the regulation upon the national interest in the commerce.'"[56]

In *Arkansas Electric*, this Court formally rejected the wholesale/retail approach to Commerce Clause issues and adopted the balance-of-interests approach it had formulated in prior Commerce Clause cases, noting that "[t]his modern jurisprudence has usually, although not always, given more latitude to state regulation than the more categorical approach of which *Attleboro* is one example."[57]

This Court further stated that the appropriate test to apply is:

> "Where [a] state statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental,

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[55] *See Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n.*, 461 U.S. 375, 389 (1983)(*Arkansas Electric*), *quoting Western & S. Life Ins. Co. v. Board of Equalization*, 451 U.S. 648, 652 (1981).

[56] *Arkansas Electric*, 461 U.S. at 390, *quoting Illinois Natural Gas Co. v. Central Ill. Pub. Serv. Co.*, 314 U.S. 498, 505 (1942).

[57] 461 U.S. at 390.

> it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."[58]

Petitioner contends that the North Carolina Supreme Court's opinion places a substantial burden on interstate commerce in violation of the Commerce Clause because it allows the trapping of costs by inconsistent regulations. Petition at 28. As previously discussed, there are no trapped costs involved in this case. The North Carolina Supreme Court's opinion disallows the Ultra Cogen capacity costs only to the extent they exceed avoided costs and are prohibited by federal law. The excess capacity costs approved by the Virginia arbitrator pursuant to state law are recoverable from Petitioner's Virginia ratepayers.

Petitioner also asserts that the North Carolina Supreme Court's decision plainly was intended to shield North Carolina electric customers from costs imposed pursuant to federal law, including the subsidization of North Carolina ratepayers. Petition at 28-29. Respondent Public Staff has shown that the disallowance upheld by the North Carolina Supreme Court was nothing more than the disallowance of costs in excess of avoided costs (i.e., prohibited by federal law), and therefore it constituted lawful retail ratemaking.

Despite Petitioner's claims to the contrary, the evidence in this case amply demonstrates that North Carolina was not motivated by economic protectionism. The uncontroverted

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[58] *Id.* at 393-94, *quoting Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

evidence demonstrates that the Virginia arbitrator's treatment of the Ultra Cogen projects was directly related to expected economic benefits to Virginia from these projects. Thus, the North Carolina Supreme Court's decision does nothing more than effectuate the legitimate local public interest of establishing just and reasonable retail rates by excluding the costs in excess of Petitioner's avoided costs. It therefore prevents those excessive costs, which were incurred pursuant to Virginia law for the benefit of Virginia, from being shifted to Petitioner's North Carolina ratepayers. The North Carolina Court's decision, therefore, has no more effect on interstate commerce than any other aspect of retail ratemaking for a utility that operates in more than one state. Almost all retail ratemaking would be a direct, and therefore unlawful, burden on interstate commerce under Petitioner's reasoning, contrary to this Court's conclusion in *Arkansas Electric* that "the national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States."[59]

The Eighth Circuit decision cited by Petitioner, *Middle South Energy v. Arkansas Public Service Commission*,[60] involved a multi-state, multi-utility integrated system, and the issue in controversy was one over which the FERC has exclusive ratemaking jurisdiction. In that respect, *Middle South* is more like *Nantahala* than the case currently before the Court. In fact, *Middle South* involved a continuation of the controversy over the Grand Gulf nuclear plant, of which *Mississippi Power* was a part.

The disallowance upheld by the North Carolina Supreme Court was nothing more than the disallowance of costs in excess of avoided costs, and therefore it constituted lawful retail ratemaking. Given the North Carolina Court's recognition of the requirements of § 210 of PURPA, Petitioner's Commerce Clause contentions are totally without merit.

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[59] 461 U.S. at 395.

[60] 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986).

CONCLUSION

This Court should deny the petition for a writ of certiorari. This case presents no conflicts with this Court's decisions and does not raise federal issues of current or general interest.

Respectfully submitted,

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APPENDIX A

Additional Statutory and Regulatory Provisions

The Federal Power Act, 16 U.S.C.A. § 824(a) (1988).

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation relating to generation to the extent provided in . . . this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

The Federal Power Act, 16 U.S.C.A. § 824a-3(b) (1988).

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase-

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

The Federal Power Act, 16 U.S.C.A. § 824a-3(e)(1) (1988).

Not later than 1 year after November 9, 1978, and from time to time thereafter, the Commission shall, . . . prescribe rules under which geothermal small power production facilities of not more than 80 megawatts capacity, qualifying cogeneration facilities, and qualifying small power production facilities are exempted in whole or part from the Federal Power Act [16 U.S.C.A. § 791a et seq.], from the Public Utility Holding Company Act [15 U.S.C.A. § 79 et seq.], from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

The Federal Power Act, 16 U.S.C.A. § 824(b)(1) (1985).

The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but. . . shall not apply to any other sale of electric energy. . .

Regulations Under the Public Utility Regulatory Policies Act of 1978, 18 C.F.R. § 292.101(b)(6) (1995).

(b) *Definitions*. The following definitions apply for purposes of this part.

(6) *Avoided costs* means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

Regulations Under the Public Utility Regulatory Policies Act of 1978, 18 C.F.R. § 292.304(d)(2) (1995).

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) The avoided costs calculated at the time of delivery; or

(ii) The avoided costs calculated at the time the obligation is incurred.

Regulations Under the Public Utility Regulatory Policies Act of 1978, 18 C.F.R. § 292.601(a)-(c) (1994).

(a) *Applicability.* This section applies to qualifying facilities, other than those described in paragraph (b) of this section.

(b) *Exclusion.* This section does not apply to a qualifying small power production facility with a power production capacity which exceeds 30 megawatts, if such facility uses any primary energy source other than geothermal resources.

(c) *General rule*. Any qualifying facility described in paragraph (a) of this section shall be exempt from all sections of the Federal Power Act, except:

(1) Section 1-18, and 21-30;
(2) Sections 202(c), 210, 211, 212, 213, and 214;
(3) Sections 305(c); and
(4) Any necessary enforcement provision of Part III with regard to the sections listed in paragraphs (c)(1), (2) and (3) of this section.

APPENDIX B

**Petition of Ultra Cogen Systems, Inc.
for Arbitration (November 12, 1987)**

VIRGINIA:

BEFORE THE STATE CORPORATION COMMISSION

At Richmond

Petition of	)	
	)	Case No. PUE87____
ULTRA COGEN	)	
SYSTEMS, INC.	)	

PETITION FOR ARBITRATION

Ultra Cogen Systems, Inc. ("UCS"), developer and owner of a qualifying cogeneration facility to be located at The Lane Co. Inc. ("Lane"), in Altavista, Virginia, having conferred and been unable to reach an agreement with Virginia Electric and Power Company ("Virginia Power") for the sale and purchase of power, hereby petitions the Commission, pursuant to its final order dated January 11, 1983, in Case No. PUE800102, to institute an arbitration proceeding to determine the terms and conditions of a power purchase agreement ("Agreement"). In support thereof, UCS states that:

1. By Letter of Intent dated November 11, 1987, Lane and UCS agreed to work jointly to develop a cogeneration project at

the Lane plant in Altavista, Virginia.[1] The project will be a qualifying cogeneration facility ("the Facility") with a maximum name plate rating of 66,500 kw, at 13.8 kv and 0.85 power factor. UCS will design, construct, own, and operate the Facility for an initial term of 15 years. UCS will provide 45,000 pounds of steam per hour on an average annual basis to Lane.[2] The Facility will burn coal which is expected to come from or be transloaded in Virginia.

2. UCS' parent, Ultrasystems, Inc. ("Ultrasystems"), has considerable experience in the design, construction, and operation of power plants. Specifically, it designs, construction and operates new, advanced technology, fluidized-bed power plants, wood-fired power plants and coal-fired plants and is a high-technology engineering and development company engaged in the development, engineering, construction, ownership and operation of electrical power generation facilities. In fact, Ultrasystems is a leader in the alternative energy, cogeneration and advanced power generation industries. It also is actively involved in numerous defense and space systems projects, with particular emphasis on command, control, communications and intelligence programs and space systems. Ultrasystems' revenues were $155.1 million for the fiscal year ended January 31, 1987 and it had a contract backlog of $304 million as of July 31, 1987.[3]

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[1] A copy of the Letter of Intent between Ultra Cogen Systems, Inc. and Lane is attached as Appendix A.

[2] An application for qualifying status has been filed with the Federal Energy Regulatory Commission. A copy of the application is attached hereto as Appendix B.

[3] On October 30, 1987, Ultrasystems and Hadson Corporation of Oklahoma City, Oklahoma announced that the Board of Directors of both companies approved a letter of intent to merge Ultrasystems and Hadson, Forming a coast-to-coast independent gas and electric company. The companies are expected to produce total revenue of more than $550 million in 1987.

3. Lane has operated its plant in Altavista, Virginia for 75 years. The plant produces fine cedar chests, tables and accent pieces. The plant employs 1,200 persons and annual sales from the plant total $100 million. Its ability to continue to operate at current levels depends upon the availability of reliable and economically priced steam, which will be provided by the Facility. The UCS and Lane cogeneration project, which will result in approximately $60 million being invested in the Altavista area, is of critical importance to the future economic health of Lane and the City of Altavista. Further, jobs and economic benefits to the community and the Commonwealth will result from the investment in and requirements of the Facility, including but not limited to the operation, maintenance and fueling of the Facility.

4. In its Final Order dated November 15, 1985, in Case No. PUE830067, Application of Virginia Electric and Power to revise Rate Schedule 19 - Power Purchases from Cogeneration and Small Power Production Qualifying Facilities, the Commission held ". . . [t]hat Schedule 19 must be revised to provide QFs [with a design capacity of 100 kw or less] the option of contracting for payments based on projected avoided energy costs either at the time the contract is executed or at the time power is delivered." 1985 SCC Ann. Rpt. 384, 390. The same options are available under regulations adopted by the Federal Energy Regulatory Commission for all QFs, including those with a design capacity in excess of 100 kw. 18 C.F.R. § 292.304(d) (2) (i) - (ii).

5. Under 18 C.F.R. § 292.303(a), Virginia Power is obliged to purchase power from UCS. Under 18 C.F.R. § 292.304, UCS is entitled to contract to sell such power at Virginia Power's long-term avoided capacity and avoided energy costs. Virginia Power has failed and refuses to contract for energy and capacity as and at the rates required by law. Such failure and refusal has been manifested (a) initially, in its proposal (and refusal to modify through negotiation) of rates and terms and conditions, which may be unfinanceable and (b) later, in its private and public refusals to negotiate on any terms or at any price.

6. UCS has expended substantial time and money in reliance on (a) Virginia Power's obligation to negotiate and (b) existing procedures and rates. Virginia Power has failed and refuses to negotiate pending anticipated revision of such procedures and rates. Further delay will unduly prejudice UCS and Lane and serve no legitimate purpose.

Accordingly, UCS respectfully submits for arbitration the following list of issues and requests that such arbitration occur forthwith and without regard to any anticipated revisions to procedures and/or rates:

A. Capacity and Energy Prices

(1) What is the appropriate rate and method of payment for long-term energy purchased from the Facility?

(2) What is the appropriate rate and method of payment for the long-term capacity purchased from the Facility?

(3) What other payments should be made by Virginia Power to UCS?

B. Terms and Conditions

(1) What is an appropriate dependability requirement for the Facility to receive full avoided cost capacity payments?

(2) Under what conditions, if any, should Virginia Power be entitled to refuse to receive and/or pay for power from the Facility?

(3) What should be the appropriate term of the Agreement, and what, if any, obligations should UCS have to repay amounts paid by Virginia Power in the event of termination of the Agreement prior to completion of its term?

(4) What, if any, security should be required for UCS' obligations under (3), above?

(5) To what extent, if any, should amounts payable pursuant to A(2) above be reduced by virtue of Facility outages or failure to meet projected output levels?

(6) What, if any, penalties or damages should UCS be required to pay for:

(a) failure to complete the Facility on schedule?

(b) failure of the Facility to produce electrical power at projected output levels?

(7) What, if any, security should UCS be required to provide for:

(a) its obligation to complete the Facility on schedule?

(b) its obligations under the Agreement after completion of the Facility?

(8) What obligations should Virginia Power have to interconnect the Facility to its system, and what, if any, obligations should UCS have to reimburse Virginia Power for the cost thereof?

(9) What should be the obligations of the parties in the event of (a) force majeure, (b) changes in law, or (c) regulatory action inconsistent with the terms or assumptions of the Agreement?

(10) What, if any, obligation should UCS have to reimburse Virginia Power for taxes incurred as a result of the transactions and activities contemplated by the Agreement?